THE FEDERAL DIARY

Protecting Pensions

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The Republican-controlled Senate Finance Committee voted yesterday to protect the pension benefits of 17 million workers from a proposed tax change that it had tentatively approved last month.

The committee rejected a House plan, which had been favored by the Reagan administration, to change the tax status of persons who pay into their own pension plans.

As retirees, these individuals pay no taxes on their pensions until they have recovered their contributions, which had been taxed during the years that they were working.

The typical fed gets back all contributions in 18 months.

The committee's voice vote on an amendment offered by Sen. John Chafee (R-R.I.) is a major, but not final, victory for opponents of the tax change that had been approved by the House.

Sen. Paul Trible (R-Va.) said he has been reassured by Chairman Bob Packwood (R-Ore.) that the committee "will not revisit" the pension tax issue, meaning that its next hurdle will come when Senate-House conferees meet to iron out a compromise tax reform package.

The House's tax reform plan eliminates the recovery period for anyone retiring after July.

The government portion of the pensions, an amount that would be determined by the life expectancy of the retiree, would be taxed immediately.

Eliminating the recovery period would disrupt retirement planning for many workers.

Most new retirees get payments for unused annual leave and that, plus other income from bonds or other jobs, is taxed at a lower rate because the annuities aren't considered taxable income during the recovery period.

Federal and postal organizations and federal agencies have warned that the House's tax plan could produce a tidal wave of retirements in June if many of the 200,000 federal workers who are eligible to retire decide to leave in order to beat the deadline.

The Senate plan that the committee voted against yesterday would have made the change fully effective in January 1988.

Congressional and White House budget experts estimate that ending the tax-free period would bring in an additional $7.5 billion to the government during the next four years.

The other way of looking at it, of course, is that the change would cost retirees $7.5 billion in taxes that they hadn't expected to pay.

But because of the prorating of the taxes, the change is considered "revenue neutral," meaning that it wouldn't mean long-term savings to the government.

A congressional task force on federal workers has estimated that changing pension tax rules would mean an unexpected $10,000 tax bite in the first three years of retirement for the typical worker, and three to four times that much for higher-paid executives.

The amount of taxes paid over a retiree's normal life span would not increase, but retirees would have to pay taxes sooner than expected.

"We're elated, but not out of the woods yet," a congressional aide said yesterday after the committee's action.

The aide pointed out that the committee has removed many features of its original tax reform plan and may yet reconsider some of them before a final tax package is approved.

This seems unlikely, however, in view of Packwood's statement to Trible.